In The

Supreme Court of the United States

October Term, 1976

No. .....
Civil 76-1393

JACK D. RINGWALT,
Petitioner,

vs.

UNITED STATES OF AMERICA,
Respondent.

PHILIP L. LIESCHE and URSULA A. LIESCHE,
Petitioners,

vs.

UNITED STATES OF AMERICA,
Respondent.

JACK D. RINGWALT and JEAN W. RINGWALT,
Petitioners,

vs.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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TO: THE HONORABLE: The Chief Justice and Associate Justices of The Supreme Court of The United States:

Your petitioners respectfully pray that a writ of certiorari issue to review the judgment and decision of the United States Court of Appeals for the Eighth Circuit entered in the above actions on February 16, 1977.

OPINIONS BELOW

The opinion of the United States Court of Appeals is not yet reported in the Federal Reporter. A copy of the opinion appears at pages 1-9 in the separate Appendix furnished herewith. The opinion of the United States District Court is unreported. This opinion also appears in the Appendix at pages 11-16.

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GROUNDS OF JURISDICTION

The judgment sought to be reviewed is a judgment of the United States Court of Appeals for the Eighth Circuit entered February 16, 1977. See Appendix, page 10. This judgment affirmed the judgment of the United States District Court for the District of Nebraska, Honorable Robert V. Denney, United States District Judge presiding (Appx. 16).

There was no petition for rehearing filed herein and there have been no extensions of time within which to petition for certiorari.

The statutory provision believed to confer on this Court jurisdiction to review the judgment in question by writ of certiorari is 28 U. S. C. Section 1254 (1).

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QUESTIONS PRESENTED FOR REVIEW

1. The principal question presented for review of this Court, broadly stated, follows:

Where a corporation which operated an insurance agency sold securities held by it as an investment and was then dissolved, and the proceeds of the liquidation were distributed to the stockholders including a bona fide Clifford trust which owned 84% of the stock, and a new agency corporation was then formed to which the operating assets of the agency were sold for valid consideration, and the trust acquired no stock in the new corporation but the grantor-trustee individually acquired 84% of the stock of the new corporation and the minority stockholders of the old corporation acquired, proportionately, the same interests in the new corporation they had held in the old one, was the transaction taxable as a corporate liquidation under 26 U. S. C. §§ 331 and 337 as contended by taxpayers, or was the transaction taxable as a "reorganization" under §§ 368 (a) (D) and 368 (c), as contended by the Treasury?

The Court of Appeals held in effect that the grantor-trustee had "beneficial ownership" of the trust estate in view of his broad powers of administration and his reversionary interest in the corpus, and that there was therefore "continuity of interest" sufficient to authorize taxation of the transactions involved under the reorganization statutes.

2. A subsidiary question, assuming arguendo the existence of a reorganization, is whether the distribution made which was added to the corpus of the trust was taxable to the grantor-trustee as ordinary income in 1967, the year of

its receipt by the trust, rather than in 1969, the year of the termination of the trust and actual receipt of the trust corpus by the grantor-trustee.

The Court of Appeals disposed of this contention by footnote stating it was not raised in the trial court and in any event was contradicted by the court's conclusion that the grantor-trustee was the owner of the trust.

STATUTORY PROVISIONS INVOLVED

The statutory provisions pertinent to this case are found in the Appendix at pages 16-24. Also found therein at pages 24-28 is particularly important and informative legislative history regarding subpart E of Part 1 of Subchapter J, 26 U. S. C. §§ 671-678, relating to the treatment of grantors and others as substantial owners for income tax purposes, and disclosing the congressional intent to mandate recognition and protection of rights of a grantor-trustee of a Clifford trust, as against claims that he is a substantial owner for income taxation purposes.

The sections of the Internal Revenue Code of 1954 (26 U. S. C.) pertinent to the issues herein follow:

(Corporations—Liquidations and Reorganizations)

§ 318 (a) (2) (B) (i) and (ii). (Appx. 16, 17)

§ 318 (b) (Appx. 17, 18)

§ 331 (a) (1) (Appx. 18)

§ 337 (a) (1) and (2). (Appx. 18)

§ 356 (a) (1) (A) and (B). (Appx. 18, 19)

§ 356 (a) (2). (Appx. 19)

§ 368 (a) (1) (D). (Appx. 19)

§ 368 (c). (Appx. 20)

(Trusts)

§ 643 (a) (3). (Appx. 20)

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§ 673 (a) (Appx. 22)

§ 674 (a) (Appx. 22, 23)

§ 674 (b) (2) (8). (Appx. 23)

§ 676 (a) (Appx. 23)

§ 676 (b) (Appx. 23, 24)

§ 677 (a) (2) (Appx. 24)

STATEMENT OF THE CASE

Procedural Facts

Separate actions were brought by petitioners and by Charles E. Wortz and wife in the United States District Court for the District of Nebraska for refund of Federal Income Taxes and interest paid by reason of deficiencies assessed by the Director of Internal Revenue for the taxable year 1967. The actions involved common issues of fact and law and were consolidated for hearing and dis-

position. Jurisdiction was invoked under 28 U. S. C. § 1340, each of the actions having been timely filed more than six months after the timely filing of refund claims under § 6511 and § 6532 of the Internal Revenue Code of 1954, as amended. Venue was grounded on 28 U. S. C. § 1391 (f).

The parties entered into a stipulation of facts and the cause was tried to the court without a jury on the stipulation and the undisputed testimony of petitioner Jack D. Ringwalt.

The District Court, the Honorable Robert V. Denney, determined the issues in favor of defendant and against the plaintiffs who are the petitioners herein. The District Court's memorandum opinion appears in the Appendix, pages 11-16, and its judgment at page 16 thereof. Motions for a new trial were overruled and appeals to the Court of Appeals pursuant to 28 U. S. C. § 1291 followed.

The plaintiffs Wortz and wife did not appeal because of the relatively small amount involved in their case. The appeals were separately docketed but were consolidated for briefing and submission. The judgment of the District Court was affirmed by the Court of Appeals. See Appendix pages 10, 11 and this petition for certiorari seeks review of the judgment of that Court.

Substantive Facts Material to Consideration of Questions Presented

The pertinent facts are undisputed and are found in the stipulation and the testimony of taxpayer Jack D. Ringwalt (hereafter sometimes referred to as "Ringwalt"). We summarize them.

Ringwalt and Liesche, Inc ("R & L, Inc.") was a Nebraska corporation organized July 1, 1949, to conduct a general insurance agency. Prior to April 30, 1959, the stockholders and their respective percentage of shares were Daniel J. Gross (2%), Philip L. Liesche ("Liesche") (8%), Ringwalt (84%), and Charles B. Wortz (6%). On the death of Mr. Gross in November, 1957, his stock was acquired by his surviving widow, Louise E. Gross. Messrs. Ringwalt, Liesche, and Wortz were the officers and directors of R & L, Inc., responsible for conduct of its business.

On April 30, 1959, Ringwalt established a short-term (or "Clifford") trust and delivered to himself as trustee all the shares he owned in R & L, Inc. The trust beneficiaries were Ringwalt's children who were entitled to the net income from the trust corpus. The trust was to continue for a period of ten years and one day and thus terminated May 1, 1969.

National Indemnity Company ("National Indemnity") and National Fire and Marine Insurance Company ("National Fire & Marine") were Nebraska insurance corporations. National Indemnity was formed by Ringwalt who was its controlling stockholder. At the beginning of 1967, approximately 51% of National Fire & Marine stock was held as an investment by R & L, Inc.

On February 23, 1967, formal offers were made by Berkshire-Hathaway, Inc., a Massachusetts corporation, to all the stockholders of National Indemnity and of National Fire & Marine to purchase their stock. On March 16, 1967, R & L, Inc. received $839,100 for the transfer of its shares of stock of National Fire & Marine with a cost basis of $132,798.13, and thereby gained $706,301.87. The net pro-

ceeds of the sale, along with other cash in the treasury of R & L, Inc., were thereafter credited or distributed by R & L, Inc., to its stockholders on a pro rata basis.

On February 22, 1967, the stockholders of R & L, Inc., by resolution directed the dissolution and liquidation of that corporation at the close of business on March 31, 1967. It was contemplated that insurance dailies and associated assets owned by R & L, Inc., would be sold to a new corporation to be formed and to commence business on April 1, 1967, R & L, Inc., was then dissolved and liquidated; and a new corporation, Ringwalt & Liesche Company ("R & L Co.") was incorporated on April 1, 1967.

Pursuant to the decision of the stockholders of the new corporation, its issued stock was held in the relative percentages of the shares in the old corporation except that while Ringwalt as trustee of the Clifford trust had held 84% of the share of R & L, Inc., Ringwalt in his individual capacity, acquired 84% of the shares of R & L Co. and the trust acquired none. Ringwalt, Liesche, and Wortz were the officers and directors of the new company. Wortz remained with the new corporation solely to train a successor and retired April 7, 1967.

The stockholders of R & L Co. paid R & L, Inc., $5,000 for the use of the similar corporate name and $165,000 for acquisition of insurance dailies and associated assets, which had been appraised by an independent appraiser.

On April 1, 1967, R & L, Inc., distributed funds to its stockholders in dissolution and liquidation, including $932,754.06 to Ringwalt as trustee of the Clifford trust and $88,833.72 to Liesche.

When the stock held by Ringwalt as trustee was redeemed, the proceeds were immediately reinvested in publicly held securities, and the trust continued without involvement with the new corporation. Ringwalt did not invest trust funds in the new R & L Co. because he felt that such an investment was too speculative in the absence of control formerly enjoyed by the old R & L, Inc., over National Indemnity, in which the insurance agency placed 80 to 90 per cent of its insurance business. Also, the new company contemplated seeking tax treatment under "Subchapter S" (26 U. S. C. §§ 1371, et seq., relating to taxable status of small business corporations), which, under the provisions of the Internal Revenue Code, would be impossible if the trust became a stockholder.

On Schedule D of his 1967 Federal Income Tax Return Ringwalt reported net long-term capital gain of $5,432,689.64, which total included $887,657.34 by reason of distribution of $932,754.06 by R & L, Inc., to Ringwalt as trustee in exchange for the shares of stock in R & L, Inc., with a reported cost basis and expenses of $45,096.72. On his 1967 Income Tax Return Schedule D, Liesche reported long-term gain of $124,502.28, including $68,142.74, by reason of distribution by R & L, Inc., of $88,833.72 in exchange for his stock with a reported cost basis and expenses of $20,690.88.

Having timely complied with requirements for reporting adoption of a plan to complete liquidation, R & L, Inc., did not report or treat as gain or other income subject to Federal taxation the net profit otherwise realized by sale of its National Fire and Marine stock.

The District Director determined that R & L, Inc., had underpaid its income tax for the fiscal year ending March

31, 1967, in the amount of $176,575.76 as tax upon a gain of $706,301.87 from the sale of its shares of stock in National Fire & Marine. This amount was assessed against Ringwalt as transferee of assets of the then dissolved R & L, Inc., and on November 18, 1971, was paid by Ringwalt, together with interest in the sum of $46,879.58. Claim for refund was filed May 16, 1972, and was disallowed December 26, 1972.

The District Director also determined that the 1967 gains reported as a result of distribution by R & L, Inc., to the Clifford trust and to Liesche, were ordinary income having the status of dividends for tax purposes, and assessed deficiencies against Ringwalt personally in the sum of $150,347.97 and Liesche in the sum of $11,401.18. On November 18, 1971, the deficiencies were paid, together with interest in the sum of $32,374.25 by Ringwalt and $2,446.69 by Liesche. Claims for refund were filed May 16, 1972, and were disallowed December 26, 1972. Thus, this proceeding involves approximately $406,175 as to the Ringwalt cases and approximately $13,848 as to the Liesche case.

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ARGUMENT AMPLIFYING REASONS FOR ALLOWANCE OF WRIT

This case presents important questions of Federal law which have not been and should be settled by this Court. Likewise, it presents questions of interpretation of Internal Revenue laws relating to Clifford trusts as applied to corporate liquidations and reorganizations. In this connection, it involves a construction of the applicable Federal laws by the courts below in a manner calculated to thwart the intention of Congress and in conflict with principles heretofore recognized by this Court and by other Courts of Appeals.

We respectfully submit that the proceeding involved herein represents an attempt by the Treasury, successful to date, to refuse proper recognition of a Clifford trust as applied to the undisputed facts because in the particular instance the impact on the taxpayers involved is far in excess of what would result if the Clifford trust were properly and fully recognized. Faced with the amendments to the Internal Revenue Code of 1954 relating to Clifford trusts, the Treasury does not openly challenge the trust itself but it flatly declines to accord to it and to the grantor-trustee and his business associates the protection mandated by Congress.

Admittedly, the subject trust was a bona fide one set up eight years before the transactions involved took place and had two years to run thereafter. However, the Treasury insists that the grantor-trustee was the owner of the trust during the ten-year duration thereof, notwithstanding specific and repeated statutory provisions to the contrary and legislative history which amplifies those provisions and makes them abundantly clear.

At the threshold, the following observations are in order. The primary purpose of the statutes regarding taxation in case of corporate reorganizations was to permit such reorganizations in appropriate instances without prohibitive tax increments. *Gorman v. Commissioner of Internal Revenue*, 302 U. S. 82, 82 Law Ed. 63, although addi-

tional tax burdens may and often do result from a reorganization. Under applicable statutes a corporate reorganization with favorable tax consequences is permitted within clearly defined limits, but a corporate reorganization without adequate business purpose is impermissible.

In the present case it was entirely unnecessary to create a new corporation upon dissolution of R & L, Inc., or to reorganize the old one, in order to carry on the insurance agency business. The business could have been conducted just as well and as efficiently by the use of a limited partnership with Mr. Ringwalt as the general partner and his business associates as limited partners, and to borrow language from the opinion of the Court of Appeals in *Commissioner of Internal Revenue v. Bergash,* 2 Cir., 1966, 361 F. 2d 257 at page 260, it is "inconceivable" that the taxpayers herein would intentionally have reincorporated if this would require the additional drastic tax burden imposed by the Treasury. As stated in *Bergash* "to adopt the Commissioner's contention would do violence to the plain meaning of the statutes". We submit that here, as in *Bergash,* the Treasury, without justification, "condemns any result which would allow a shareholder to withdraw accumulated earnings at capital gains rates in a reincorporation transaction * * * ". We further submit that the decision of the Court of Appeals herein conflicts with that of the Second Circuit in *Bergash.*

A central and ironical defect of the decision sought to be reviewed is that it opens the door for the astute tax practitioner upon the very evil trafficing in the tax advantage of accumulated corporate net operating losses which 26 U. S. C. Section 368 was originally adopted to combat

through the error of misconstruing as a "mere reorganization" and, therefore, as one continuous corporate entity liquidated predecessor and newly organized successor corporations in the first of which an individual personally owned at least 80% of its shares and in the second of which the same individual as trustee of a short-term ("Clifford") trust held at least 80% of its shares for income beneficiaries with reversion of principal. In the particular involved instance, the existence of a "mere reorganization" benefited tax revenue collection by transforming what the taxpayer had reported as long-term capital gain into ordinary dividend income; but, if the decision below is sustained, it offers a technique by which the shareholders of a profit corporation can acquire a loss corporation and shelter income from taxation despite the carefully worked out rules of Section 368.

It is quite impossible to avoid argument on the merits in support of our petition for allowance of the writ. We do, however, limit our argument to what we deem essential to establish that certiorari is in order. If it is granted we shall amplify that argument and examine more fully the reasoning of the Court of Appeals and the correctness of its ultimate determination.

Historical Background of Clifford Trusts

In 1940, this Court decided *Helvering v. Clifford,* 309 U. S. 331, 81 L. Ed. 788, 60 S. Ct. 554, which held that while the short-term trust involved therein was not taxable under § 166 of the Internal Revenue Code of 1939 [corresponding to § 676 of the 1954 Code as modified (Appx. 23)], it was taxable under the general provisions

of § 22a (now § 61) broadly defining gross income.[1] The majority opinion in *Clifford* pointed out that its construction of the law was premised on the absence of "more precise standards or guides supplied by statute" or regulations.

Clifford was followed by a series of Court decisions and administrative rulings which culminated in the additions and revisions contained in Subpart E of Part 1 of sub-chapter J of the Internal Revenue Code of 1954, 26 U. S. C. § 671, et seq., relating to grantors and others treated as substantial owners, wherein precise standards were enunciated.

As stated in the House Report concerning § 671 (Appx. 25):

> "It is also provided in this section that no items of a trust shall be included in computing the income or credits of the grantor (or another person) solely on the grounds of his dominion and control of the trust under the provisions of section 61 (corresponding to sec. 22(a) of existing law). *The effect of this provision is to insure that the taxability of Clifford type trusts, shall be governed solely by this subpart.*" (Emphasis added.)

The statutes relating to treatment of a trustee-grantor as a substantial owner for income taxation purposes and having relevance here are set out in the Appendix at pages 20 to 24. They are sections 671, 673, 674, 676, and

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1 The Court will note the strong dissenting opinion of Mr. Justice Roberts in which Mr. Justice McReynolds joined. See also **Helvering v. Wood,** 309 U. S. 344, 84 L. Ed. 797, 60 S. Ct. 551, decided on the same day as **Clifford,** and also holding that the short-term trust involved was not taxable under § 166.

677 which, being in pari materia, must be construed together. All of these statutes recognize that the grantor of a bona fide Clifford trust shall not be treated as the owner thereof for taxation purposes prior to the expiration of the 10-year period requisite to validity of the trust.

Section 673 (a) of the Internal Revenue Code (Appx. 22) sets out the general rule regarding reversionary interests and provides that the grantor shall be treated as the owner of any portion of the trust in which he has a reversionary interest "in either the corpus or the income therefrom *if, at the inception of that portion of the trust*" the interest will or may reasonably be expected to take effect in possession or enjoyment "*within ten years*" commencing at the date of the transfer of that portion of the trust. (Emphasis added.)

Under 26 U. S. C. 671 (Appx. 21), mere domination and control over the trust is declared to be insufficient to require items of a trust to be included in computing taxable income and credits of the grantor except as specified in Subpart E (26 U. S. C. §§ 671-678). Section 674 (Appx. 22) relating to power to control beneficial ownership excepts a power which can only affect beneficial ownership of the income for a period commencing after expiration of the period such that the grantor would not be treated as the owner under § 673 if the power were a reversionary interest. Section 676 (Appx. 23) relating to power to revoke contains substantially the same provision.

Section 677 (Appx. 24) relates to income for the benefit of the grantor. It requires the grantor to be treated as the owner of any portion of the trust whose income, at the discretion of the grantor, may be held or accumulated for

future distribution to the grantor. It then specifically provides:

> "*This subsection shall not apply to a power the exercise of which can only affect the beneficial enjoyment of the income for a period commencing after the expiration of a period such that the grantor would not be treated as the owner under § 673 if the power were a reversionary interest;* but the grantor may be treated as the owner after the expiration of the period unless the power is relinquished." (Emphasis added.)

The Question Whether There was a "Liquidation" or a "Reorganization"

The principal question presented is whether there was a "complete liquidation" of R & L, Inc., or a mere "reorganization" thereof for Federal income tax purposes. The courts below held that there was a "reorganization" because the taxpayer Ringwalt who was the grantor-trustee of the Clifford trust which owned 84% of the stock of R & L, Inc., acquired individually 84% of the stock in R & L Co.

That there was a dissolution and liquidation of R & L, Inc., is not disputed and it is settled law that a "complete liquidation" as distinguished from a "reorganization" is not precluded by the fact that the business venture involved is continued by a newly organized corporation. See *Commissioner of Internal Revenue v. Bergash*, 2 Cir. 1966, 361 F. 2d 257, affirming 43 T. C. 743; *Joseph C. Gallagher*, 1962, 39 T. C. 144; *Rommer v. U. S.*, D. C. N. J. 1966, 268 F. Supp. 740; 26 U. S. C. §§ 331 (a), 337 (a) (Appx. 18).

The reorganization statutes involved, 26 U. S. C. § 368 (a) (1) (D) and § 368 (c), are set out in the Appendix at

pages 19, 20. Paragraph (D) of § 368 (a) (1) defines as a "reorganization" a transfer by a corporation of assets to another corporation if, immediately after the transfer, the transferor corporation, one or more of its stockholders, or any combination thereof, is *in control* of the corporation to which the assets are transferred. Section 368 (c) defines "control" as *ownership* of stock possessing at least 80% of the total combined voting power of all classes of stock entitled to vote, and of all other classes of stock of the involved corporation. The Court of Appeals held that Ringwalt individually was appropriately treated as the owner of 84% of the R & L, Inc., stock because of "the significant incidence of his ownership over the trust property". It held that assessing continuity of interest depended upon "beneficial ownership without regard to the existence or absence of legal title". The Court of Appeals pointed out that Ringwalt had numerous powers of administration over the trust and retained a reversionary interest in the corpus and stated "the trust assets were subject to execution by Ringwalt's creditors".[2] The Court of Appeals stated that "Most significantly, examination of the declaration of trust reveals that Ringwalt as trustee possessed extensive power to allocate trust receipts between principal and income".

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2 The Court of Appeals cites no case to sustain this conclusion. The Court apparently relied upon a similar statement in the appellee's brief in the Court of Appeals which cited in support of such statement **First National Bank of Omaha v. First Cadco Corp.**, (1973) 189 Neb. 734, 205 N. W. 2d 115. That case involved a spendthrift trust and held that the trust corpus could be garnished after and only after the trust expired and the beneficiary had a right to demand the proceeds. Thus, the case is not authority for a proposition that the trust assets would be subject to execution by Ringwalt's creditors prior to the expiration of the 10-year period.

The holding of the Court of Appeals is diametrically contrary to the declared intent of Congress. Inherent in a Clifford trust is the retention by the grantor-trustee of broad powers of administration over the trust and a retained reversionary interest therein. As we have shown, the statutes enacted in 1954 specifically except Clifford trusts from the provisions relating to taxation of a grantor as the substantial owner of the trust. 26 U. S. C. § 673 recognizes that the reversionary interest of a grantor of a Clifford trust shall not have the effect of causing him to be treated as the owner thereof.

As to the power to allocate trust receipts between principal and income, on which the Court of Appeals placed much emphasis and significance, we call attention to 26 U. S. C. § 674 (Appx. pages 22, 23). Under Section 674 (a) a grantor is to be treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the corpus or income is subject to a power of disposition exercisable by the grantor without approval of an adverse party. Section 674 (b) (8) provides for exceptions including (Appx. 23) *"Power to allocate between corpus and income.* A power to allocate receipts and disbursements as between corpus and income, even though expressed in broad language."

The Court of Appeals in holding that Ringwalt individually "was the beneficial owner" of the trust for taxation purposes within § 368 (a) and (c) so that there was continuity of control and a reorganization, disregarded the mandate of Congress as disclosed by the provisions of Subpart E of Part 1 of Subchapter J.

As we have noted, the decision of the Court of Appeals which we urge this Court to review on Certiorari conflicts with *Commissioner of Internal Revenue v. Bergash, supra.* It also conflicts with the principal announced in *Commissioner of Internal Revenue v. Gordon,* 2 Cir. 1967, 382 F. 2d 499, holding that the Commissioner, who then urged a very strict construction of the reorganization statutes, was precluded from changing his position on strict or broad construction to suit his purpose in the particular instance, and that in determining tax results the Court should view the business transaction as a whole in conjunction with the underlying purpose of the statutes.

The Court of Appeals also failed to give effect to 26 U. S. C. § 318 (Appx. 16, 17) relating to constructive ownership of stock for purposes of Subchapter C (regarding corporate distributions and adjustments) and to cases construing § 318. The claim that Ringwalt was the beneficial owner of the R & L, Inc. stock during the existence of the trust is in effect a claim of constructive ownership at that time. Section 318 includes numerous specific rules for dealing with constructive ownership, none of which provides for application to §§ 331, 337, or 368. Section 368 (c) defines "control" for the purposes of Parts I, II, and III of Subchapter C relating to corporate distributions and adjustments (other than § 304 of Part I) and does not purport to fall within the ambit of § 318. Nor is § 368 (c) referred to in § 318 (b). On the other hand, by way of example, 26 U. S. C. § 304 (c) defining "control" in another context specifically states in subparagraph 2 that § 318 (a) shall apply for purposes of determining control, and § 304 is specifically referred to in § 318 (b).

The courts hold that § 318 (a) applies exclusively to the sections referred to in § 318 (b). See *Estate of Byrd v. Commissioner of Internal Revenue,* 5 Cir. 1967, 388 F. 2d 223; *Stanton v. U. S.,* D. C. E. D. Penn., 1974, 371 F. Supp. 103. In *Stanton* it was held that § 318 (b) of the Code specifically precludes application of the constructive ownership rules thereof to § 368 by its failure to refer to that section. In the instant case the Court of Appeals did not refer to § 318 although it was specifically called to the Court's attention.

As indicated on page 4, supra, the decision of the Court of Appeals made short shrift of the contention disclosed by the second question presented for review herein. In footnote 11 (Appx. 9) the Court stated that the contention "was not raised at trial" and was contradicted by the conclusion of the Court of Appeals that Ringwalt should be characterized as the owner of the short-term trust.

First we note that the issue was within the broadly pleaded allegations of the complaint in each of the Ringwalt cases, and that it arose only because of the district court's holding adverse to the taxpayers on the main question. There was no reason to litigate the matter in the trial court.

Under the terms of the trust Ringwalt individually could in no event receive income in the nature of corporate dividends prior to May 1, 1969, when the Clifford trust terminated. Assuming, arguendo, that there was a corporate reorganization, distribution of proceeds of the liquidation of R & L, Inc., which was added to the trust corpus in 1967, was not taxable as ordinary income to Ringwalt in 1967 but only in 1969 when the trust terminated and the trust corpus reverted to Ringwalt.

Under 26 U. S. C. § 677 (a) (2), providing that capital gains become a part of the corpus of a Clifford trust payable to the grantor on termination of the trust, the capital gains from the sale of securities comprising corpus constitute income "accumulated for future distribution to the grantor". See *Commissioner of Internal Revenue v. Wilson,* 7 Cir. 1942, 125 F. 2d 307; *Graff v. Commissioner of Internal Revenue,* 7 Cir. 1941, 117 F. 2d 247; *Scheft v. Commissioner of Internal Revenue,* 1972, 59 T. C. 428. For that reason, Mr. Ringwalt treated the R & L, Inc., distribution to the trust as part of the principal set aside for return to himself individually on termination of the trust and taxable to himself individually to the extent of the long-term capital gain realized in the taxable year of distribution. That is in no way inconsistent with the position that the trust owned the corpus and that the gain to the trust estate from the sale of the National Fire & Marine Stock distributed in the course of liquidation of R & L, Inc., was not and could not be ordinary income to Ringwalt in the nature of corporate dividends in 1967.

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CONCLUSION

The decision of the Court of Appeals violates the statutory mandate of Congress regarding treatment, taxwise, of Clifford trusts as applied to corporate liquidations and reorganizations. It also violates common-law principles of trusts. It is, to say the least, incompatible with decisions of Courts of Appeals of other circuits.

Involved herein are questions of continuing importance in the field of taxation. This Court has the oppor-

tunity to settle now questions of Federal law regarding the revenue which must eventually be determined. While in this particular case the Treasury gains by the strained construction given to the applicable statutes, and the taxpayers pay a heavy penalty for failure to anticipate that construction, there will doubtless be many instances in the future when the decision of the Court of Appeals if permitted to stand will return to haunt the Treasury and, if followed, prove this to be an empty victory indeed. As stated by the Court of Appeals for the First Circuit in *Lewis v. Commissioner of Internal Revenue,* 1 Cir. 1949, 176 F. 2d 646 at page 648:

> "Sometimes the taxpayer seeks to establish that a statutory reorganization did not take place. E. g., Survaunt v. Commissioner, 8 Cir. 1947, 162 F. 2d 753. Other times the Commissioner takes that position. E. g. Bazley v. Commissioner, 1947, 331 U. S. 737, 67 S. Ct. 1489, 91 L. Ed. 1782, 173 A. L. R. 905. Our determination of the substantive question must not be controlled by whether in the particular case it is to the advantage of the government or of the taxpayer to make out that no statutory reorganization has been effected. See Lyon, Inc. v. Commissioner, 6 Cir. 1942, 127 F. 2d 210, 213. 'Rather, the effort should be to seek out the true intendment of the law, let the chips fall how they may in the particular litigation. Otherwise, to change the metaphor, interpretative chickens may come home to roost at a time when the barnyard wears quite a different aspect.' Portland Oil Co. v. Commissioner, 1 Cir., 1940, 109 F. 2d 479, 488."

Petitioners respectfully pray that certiorari be granted herein to review the judgment and decision of the United States Court of Appeals for the Eighth Circuit.

Respectfully submitted,

HAROLD W. KAUFFMAN and
WILLIAM A. DAY, JR.,

Of: GROSS, WELCH, VINARDI, KAUFFMAN & DAY

525 Farm Credit Building
Omaha, Nebraska 68102

Attorneys for Petitioners

APPENDIX

In The

Supreme Court of the United States

October Term, 1976

o

No. Civil 76-1393

o

JACK D. RINGWALT,
Petitioner,

vs.

UNITED STATES OF AMERICA,
Respondent.

PHILIP L. LIESCHE and URSULA A. LIESCHE,
Petitioners,

vs.

UNITED STATES OF AMERICA,
Respondent.

JACK D. RINGWALT and JEAN W. RINGWALT,
Petitioners,

vs.

UNITED STATES OF AMERICA,
Respondent.

o

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

o

HAROLD W. KAUFFMAN
and WILLIAM A. DAY, JR.,
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APPENDIX INDEX

OPINION

UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT

No. 76-1285

Jack D. Ringwalt,

Appellant,

vs.

United States of America,

Appellee.

No. 76-1286

Philip L. Liesche and
Ursula A. Liesche,

Appellants,

vs.

United States of America,

Appellee.

No. 76-1287

Jack D. Ringwalt and
Jean W. Ringwalt,

Appellants,

vs.

United States of America,

Appellee.

Appeals from the United States District Court
for the District of Nebraska

Submitted: December 16, 1976
Filed: February 16, 1977

Before STEPHENSON and HENLEY, Circuit Judges, and MEREDITH,* District Judge.

STEPHENSON, Circuit Judge.

Jack D. Ringwalt and other taxpayers[1] appeal from the district court's[2] judgment disallowing their claims for income tax refunds for the year 1967. In this appeal appellants contend the district court erred in concluding that certain corporate transactions constituted a corporate reorganization rather than a liquidation producing more favorable tax treatment. For the reasons stated below, we affirm.

The basic facts are described in a stipulation adopted by the district court. In 1949 Ringwalt organized a general insurance agency entitled Ringwalt & Liesche, Inc. (R & L, Inc.). Ringwalt, owning 84% of the shares in the corporation, served as its president. On April 30, 1959, Ringwalt established a trust for the benefit of his children, and he transferred all of his shares in R & L, Inc. to himself as trustee. The trust, commonly known as a Clifford Trust, was specified to last until May 1, 1969, with the trust income being distributable and taxable to the children during the ten-year period. Ringwalt retained a reversionary interest in the trust corpus and

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* The Honorable James H. Meredith, Chief Judge, United States District Court for the Eastern District of Missouri, sitting by designation.

1 Reference to taxpayers includes Jack Ringwalt, Jean Ringwalt, Philip Liesche, and Ursula A. Liesche.

2 The Honorable Robert V. Denney, United States District Judge for the District of Nebraska.

held various administrative powers as trustee, including sole discretion to allocate trust receipts between principal and income.

The critical events for purposes of this appeal consist of the sale by R & L, Inc. of a major asset, the dissolution of R & L, Inc., and the subsequent formation of a new insurance corporation. The record reflects that Ringwalt had formed several insurance companies, including National Fire and Marine Insurance Company. R & L, Inc. owned 51% of the shares in National Fire and Marine, but on March 16, 1967, sold its entire interest to Berkshire-Hathaway, Inc. R & L, Inc. realized a taxable gain on the sale exceeding $700,000. Shortly afterward, the shareholders of R & L, Inc. adopted a resolution authorizing dissolution of the corporation effective March 31, 1967. Ringwalt & Liesche Co. (R & L Co.) was organized on April 1, 1967, with respective shareholders similar to those of R & L, Inc. but with one exception: Ringwalt, rather than the trust, obtained an 84% interest in the new corporation. R & L Co. purchased the operating assets and corporate name of R & L, Inc. and proceeded to conduct the business formerly conducted by R & L, Inc. in substantially the same manner and at the same location.

On April 1, 1967, R & L, Inc.'s assets were distributed to its shareholders in connection with its dissolution. In particular, $932,754.06 was distributed to Ringwalt as trustee of the short-term trust. These funds were subsequently reinvested in publicly-held securities because, in Ringwalt's view, investment in R & L Co. would have been unduly speculative.

In their individual federal income tax returns for the year 1967, Ringwalt and the other taxpayers treated the distribution received from R & L, Inc. as a corporate liquidation[3] and reported long-term capital gain. R & L, Inc., similarly treating the distribution as a liquidation,[4] reported no gain with respect to the sale of the National Fire and Marine stock or the transfer of the operating assets to R & L Co. In contrast, the Internal Revenue Service determined that the series of transactions through which R & L, Inc. transferred its assets to R & L Co. and then dissolved constituted a corporate reorganization[5] rather than a liquidation. Accordingly, the Internal Revenue Service treated the liquidating distribution as essentially equivalent to a dividend, which is ordinary income,[6] as opposed to capital gain, which would have been appropriate if the transactions were treated as a corporate liquidation. Income tax deficiencies were assessed against Ringwalt and the other taxpayers; Ringwalt's deficiency was approximately $150,000.

After payment of the tax, the taxpayers initiated refund actions in the district court. The district court, holding in favor of the United States, concluded that the dissolution of R & L, Inc. and subsequent creation of R & L Co. was correctly treated as a corporate reorganization, and the court dismissed the taxpayers' claims for refunds.

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3 **See** I. R. C. § 331 (a) (1).

4 **See** I. R. C. § 337 (a).

5 **See** I. R. C. § 368 (a) (1) (D).

6 **See** I. R. C. § 356.

The central issue in this appeal obviously is whether the series of corporate transactions described above should be treated as a corporate reorganization or a liquidation. A corporate liquidation consists of the cessation of business by the corporation and the distribution of its assets to its shareholders. *See, e.g.,* I R. C. § 332. A corporate reorganization constitutes a continuation of business activity by the same shareholders in modified corporate form. *See* I. R. C. § 368. *See generally* B. Bittker & J. Eustice, Federal Income Taxation of Corporations and Shareholders ¶ 14.54 (3rd ed. 1971).

In a liquidation, favorable tax treatment may be appropriate in that the distribution can be reported as a capital gain by a shareholder, and no gain need be recognized by the corporation. *See* I. R. C. §§ 331 and 337. Nevertheless, such advantageous tax treatment is denied when an ostensible liquidation is tainted by reincorporation of the original corporation's operating assets in a "new" corporation controlled by the same shareholders. *See* I. R. C. § 368. In that situation, the series of corporate transactions constituting a liquidation-reorganization is collapsed, and the tax treatment accorded to reorganizations preempts that accorded to complete liquidations.[7] *See Babcock v. Phillips,* 372 F. 2d 240, 242-44 (10th Cir.), *cert. denied,* 387 U. S. 918 (1967); *Davant v. Commissioner,* 366 F. 2d 874, 879-83 (5th Cir. 1966), *cert. denied,* 386 U. S. 1022 (1967); *Commissioner v. Morgan,* 288 F. 2d 676, 679-80 (3d Cir.), *cert. denied,* 368 U. S. 836 (1961); *Liddor v. Commissioner,* 230 F. 2d 304, 307-09 (6th Cir.),

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7 Distributions of money or property by the corporation to its shareholders incident to the reorganization generally will constitute ordinary dividend income. I. R. C. § 356.

cert. denied, 352 U. S. 824 (1956); *Bard-Parker Co. v. Commissioner,* 218 F. 2d 52, 56-57 (2d Cir. 1954), *cert. denied,* 349 U. S. 906 (1955); *Lewis v. Commissioner,* 176 F. 2d 646, 648-49 (1st Cir. 1949); *Survaunt v. Commissioner,* 162 F. 2d 753, 756-59 (8th Cir. 1947).

We conclude that the dissolution of R & L, Inc. and concomitant incorporation of R & L Co. should be construed as a reorganization rather than a liquidation. The series of transactions that took place in the instant case appears governed by I. R. C. § 368 (a) (1) (D), which defines a reorganization as:

> a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, is in control of the corporation to which the assets are transferred; but only if, in pursuance of the plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under Sections 354, 355, or 356.

To hold otherwise would be to recognize form over substance under circumstances in which there was a continuation of an existing business enterprise as opposed to the termination of a going concern. *See Davant v. Commissioner, supra,* 366 F. 2d at 879-87; *Commissioner v. National Bellas Hess, Inc.,* 220 F. 2d 415, 418-21, *rehearing denied,* 225 F. 2d 340 (8th Cir. 1955).

Taxpayers' most critical contention, in claiming that the series of corporate transactions described above should not have been treated as a reorganization, is that a reorganization requires a consistency of ownership between

the original corporation and the surviving corporation, allegedly absent in this case. *See, e.g., Halvering v. Southwest Corp.,* 315 U. S. 194, 201-02 (1942). Taxpayers emphasize, in this regard, that Ringwalt held an 84% interest in R & L, Inc. only as trustee under a short-term trust and owned in his individual capacity an 84% interest in R & L Co. Accordingly, they assert that the common control requirement for a reorganization under Section 368 (a) (1) (D) has not been met.[8] The government contends, however, that Ringwalt did have sufficient control as trustee for the Clifford Trust in order to satisfy the common control element of a reorganization.

In determining that the continuity of interest requirement had been established in the instant case, the district court specifically found that Ringwalt was treated appropriately as the owner of 84% of the R & L, Inc. stock because of the significant incidence of his ownership over the trust property. We agree. The district court's finding is adequately supported by the record.

Assessing continuity of interest ultimately depends upon proof of beneficial ownership without regard to the existence or absence of legal title. *See Bondy v. Commissioner,* 269 F. 2d 463, 466-67 (4th Cir. 1959); *Commissioner v. National Bellas Hess, Inc., supra,* 220 F. 2d at 421. *Cf. Kamborian v. Commissioner,* 469 F. 2d 219, 221-

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8 In a reorganization, one or more of the shareholders of the transferor corporation must own at least 80% of the stock of the transferee corporation. See I. R. C. § 368 (a) (1) (D). The key question in this case is whether Ringwalt was a "shareholder" of the transferor corporation in view of his powers as trustee of the Clifford Trust.

22 (1st Cir. 1972). The only beneficial right that Ringwalt relinquished under the trust agreement was the right to receive trust receipts allocable to income. However, Ringwalt had numerous powers of administration over the trust. The trust assets were subject to execution by Ringwalt's creditors. Ringwalt also retained a reversionary interest in the corpus of the trust to insure that he would be entitled to total control after ten years.

Most significantly, examination of the declaration of trust reveals that Ringwalt as trustee possessed extensive power to allocate trust receipts between principal and income. I. R. C. § 677 (a) (2) provides that the grantor of a trust shall be treated as the owner when the trust income may be held or accumulated, in the grantor's uncontrolled discretion, for future distribution to himself.[9] *See Helvering v. Clifford,* 309 U. S. 331, 334-38 (1940). *Cf. Swanson v. Commissioner,* 518 F. 2d 59, 63 (8th Cir. 1956). In accordance with Ringwalt's powers as trustee, the 1967 liquidating distribution received from dissolution of R & L, Inc. was allocated to principal, held by the trust for future distribution and actually distributed to Ringwalt upon termination of the trust in 1969.

Under these circumstances, it appears that Ringwalt should be treated as the owner of the Clifford Trust, pur-

9 Section 677 infers that the grantor will not be treated as the owner of a trust if his power to pay or accumulate income for his own benefit can only affect th beneficial enjoyment of the income after ten years. Nonetheless, we reject appellants' suggestion that a grantor cannot be treated as the owner of a trust if **distribution** of accumulated income takes place after the ten-year period. Section 677 attributes ownership to a grantor whenever the power to pay or accumulate income is exercisable during the ten-year period without regard to the timing of actual distribution.

suant to section 677 (a) (2),[10] and correspondingly we hold that the common control requirement for a reorganization, defined by section 368, was satisfied.[11] *See United States v. Adkins-Phelps, Inc.,* 400 F. 2d 737, 740-43 (8th Cir. 1968). The transactions that occurred in the instant case, which in substance were really a continuation of the insurance business rather than its cessation were properly characterized as a reorganization.

Affirmed.

A true copy.

Attest:

CLERK, U. S. COURT OF APPEALS,
EIGHTH CIRCUIT.

10 Interestingly, Ringwalt did report the gain from the R & L, Inc. liquidation distribution on his individual income tax return for the year 1967.

11 Ringwalt alternatively contends that the R & L, Inc. liquidation distribution was taxable in 1969 upon termination of the trust rather than in 1967, the year of dissolution. This assertion was not raised at trial and, in any event, is contradicted by our conclusion that Ringwalt should be characterized as the owner of the short-term trust.

JUDGMENT

UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT

September Term, 1976
Feb. 16, 1977
Robert C. Tucker, Clerk

No. 76-1285

Jack D. Ringwalt,

Appellant,

vs.

United States of America,

Appellee.

No. 76-1286

Philip L. Liesche and
Ursula A. Liesche,

Appellants,

vs.

United States of America,

Appellee.

No. 76-1287

Jack D. Ringwalt and
Jean W. Ringwalt,

Appellants,

vs.

United States of America,

Appellee.

Appeals from the United States District Court
for the District of Nebraska

These causes came on to be heard on the original designated record of the United States District Court for the District of Nebraska and briefs of the respective parties and were argued by counsel.

On Consideration Whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court in these causes be and the same are hereby affirmed.

February 16, 1977

OPINION OF THE DISTRICT COURT

(Filed November 12, 1975)

DENNEY, District Judge

These consolidated cases come before the Court for decision following trial to the Court on July 23, 1975. The parties have stipulated to virtually all of the pertinent facts, and that stipulation (Filing #16) is adopted herein as part of the Court's findings of fact, pursuant to F. R. Civ. P. 52 (a).

The actions arise under 28 U. S. C. § 1340 for refund of approximately $420,000 based on claims timely filed pursuant to 26 U. S. C. §§ 6511 and 6532.

In 1967, the plaintiff's were stockholders of Ringwalt & Liesche, Inc. (hereinafter R & L Inc.), a Nebraska corporation, engaged in the insurance business as a general agent. Jack Ringwalt had been the majority shareholder (84%) for several years; however, during the time in question his stock was held by himself as trustee under a

"Clifford" trust for the benefit of his children. A very substantial proportion of the policies written by R & L Inc. were placed with National Indemnity (hereinafter NI) or National Fire and Marine (hereinafter NF & M) insurance companies. R & L Inc. owned a majority of the stock of NF & M and plaintiff Ringwalt was the president of all three companies.

All the stock of NI and NF & M was purchased in 1967 by Berkshire-Hathaway Inc. R & L Inc. then adopted a resolution directing the dissolution and liquidation of the corporation, while the assets of R & L Inc. were to be transferred to a new corporation.

From the sale of NI, R & L Inc. received $839,100 for the stock it held (cost basis of $132,799) and distributed the proceeds to its stockholders.

Ringwalt & Liesche Co. (hereinafter R & L Co.) was then formed with the stockholders holding the same percentage of shares as they held in R & L Inc., except that Jack Ringwalt held his percentage (84%) in his own right—not as trustee. When the R & L Inc. stock held by Jack Ringwalt as trustee was redeemed the proceeds were reinvested into publicly held securities and the trust continued without any involvement with the new corporation, R & L Co. Mr. Ringwalt testified that he did not reinvest the proceeds in R & L Co. because he thought such an investment was too speculative due to the fact that the new company, R & L Co. had no control over its largest customers, NI and NF & M. In addition, he stated that the new corporation might seek "Subchapter S" treatment, which would be impossible if a trust was a large shareholder.

The new corporation carried on the business of the old corporation, without substantial change. Ringwalt, Liesche and Wortz continued as Directors and President, Vice-President and Treasurer, respectively. In addition, the new corporation was officed at the same location and retained substantially the same employees. Mr. Ringwalt continued as president of NI and NF & M for six years, when Mr. Liesche became president.

On its Federal Tax Return for 1967, R & L Inc. did not treat the $706,301 (equal to $839,100 minus $132,799) as a gain subject to taxation. On the stockholders' individual tax returns for that year, they treated their share of the distribution as long term capital gain. The District Director then commenced an audit of the 1967 tax returns of both Mr. Ringwalt and Mr. Liesche. Both men filed claims which were allowed and checks were sent in the spring of 1971 to Mr. Ringwalt and Mr. Liesche; however, both men offered to return the checks and informed the District Director of their concern over the holding in *Lewis v. Reynolds*, 248 U.S. 281 (1932). See Stipulation Exhibit No. 12. Shortly thereafter, the District Director determined that R & L Inc. had underpaid its federal income tax for 1967 in the amount of $176,575.76. While Ringwalt was assessed $150,347.97, Liesche was assessed $11,401.18 and Wortz was assessed $2,467.17. Mr. Ringwalt paid both the deficiency of R & L Inc. and of the trust.

Plaintiffs Ringwalt and Liesche contend that the Government is estopped from seeking a deficiency by reason of the relatively minor ($2,560.61) refunds they received for that year. In *Lewis v. Reynolds*, 284 U.S. 281 (1932),

the taxpayer sued for a refund of tax for a year for which, due to the passage of time, the Commissioner could not seek a deficiency. The Court held that even though the Commissioner could not seek a deficiency, he was permitted to reaudit the return to determine if the amount claimed as a refund was offset by an improper deduction. Plaintiffs' reliance on *Lewis v. Reynolds* is misplaced as the case of *Burnet v. Porter,* 283 U. S. 230 (1931) is controlling, wherein the Court held that the Commissioner may allow a claim for refund, and then at some time later reopen the case and redetermine the tax.

Turning to the merits of the case, the Government contends that the sums received by plaintiffs were ordinary income as the provisions of 26 U. S. C. § 368 (a) (1) (D) apply. Plaintiffs, however, allege that the "control" provision of § 368 (a) (1) (D) is not satisfied, since R & L Inc. was controlled by a trust, while R & L Co. is controlled by an individual. *Ralph C. Wilson,* 46 T. C. 334 (1966); *David T. Grubbs,* 39 T. C. 42 (1962); and Tres. Reg. § 1,368-1 (b), illustrate the tax consequences of a typical § 368 (a) (1) (D) reorganization. This Court concludes that the issue of "control" is of paramount importance to this case.

> The statutory language is as follows:
> (The term Reorganization means) . . . A transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, is in control of the corporation to which the assets are transferred . . . The term "control" means the ownership of stock possessing at least 80 percent of the total combined power of all classes of stock . . . 26 U. S. C. § 368.

The facts of the present case, when applied to the statutory language, indicate that Mr. Ringwalt, as self-appointed trustee, had legal ownership of 84% of the stock of the transferor corporation. He also retained a reversionary interest in the res which was to revert in appoximately two years after the transfer of corporate assets. The equitable interest of the trust was never distributed to the beneficiaries, but was kept in the trust. After much research, the Court has found few cases of assistance in resolving the issue before the Court. *Commissioner v. National Bellas Hess,* 220 F. 2d 415 (1955), Reh. Den. 225 F. 2d 340 (8 Cir. 1955); *Kamborian v. Commissioner,* 469 F. 2d 219 (1 Cir. 1972); *West Side Savings & Loan Assn. v. United States,* 494 F. 2d 404 (6 Cir. 1974); *see also,* Rev. Rul. 75-95 (1975).

The present case evidences little business purpose, aside from avoidance of taxes, to a reorganization. When R & L Inc. sold its interest in NI and NF & M, that asset was not necessary to the continuation of the business, when R & L Co. was formed there was virtually no change in the business.

It should be noted that in this case the Clifford trust was formed well before the reorganization; however, the Court is aware of the likelihood that trusts of short duration could be easily employed to defeat the clear purpose of section 368, should the Court deny reorganization status in this case.

For these reasons, the Court must find in favor of the United States. An order in accordance with the find-

ings of fact ad conclusions of law is filed contemporaneously herewith.

Dated this 12th day of November, 1975.

JUDGMENT OF THE DISTRICT COURT

O R D E R

(Filed November 12, 1975)

In accordance with the Court's memorandum filed contemporaneously herewith:

IT IS THEREFORE ORDERED that judgment be entered in favor of the defendant in each of the four above captioned cases.

Dated this 12th day of November, 1975.

BY THE COURT

Robert V. Denney
United States District Judge

PERTINENT STATUTES

Internal Revenue Code of 1954 (26 U. S. C.):

• • • • •

[Corporations—Liquidations and Reorganizations]

§ 318. *Constructive ownership of stock.*

(a) General rule.—For purposes of those provisions of this sub-chapter to which the rules contained in this section are expressly made applicable—

• • • • •

(2) *Attribution from partnerships, estates, trusts, and corporations.*—

• • • • •

(B) *From trusts.*—

(i) Stock owned, directly or indirectly, by or for a trust (other than an employees' trust described in section 401(a) which is exempt from tax under section 501 (a)) shall be considered as owned by its beneficiaries in proportion to the actuarial interest of such beneficiaries in such trust.

(ii) Stock owned, directly or indirectly, by or for any portion of a trust of which a person is considered the owner under subpart E of part I of subchapter J (relating to grantors and others treated as substantial owners) shall be considered as owned by such person.

• • • • •

(b) Cross references.—

For provisions to which the rules contained in subsection (a) apply, see—

(1) section 302 (relating to redemption of stock);

(2) section 304 (relating to redemption by related corporations);

(3) section 306 (b) (1) (A) (relating to disposition of section 306);

(4) section 334 (b) (3) (C) (relating to basis of property received in certain liquidations of subsidiaries);

(5) section 382 (a) (3) (relating to special limitations on net operating loss carryovers);

(6) section 856 (d) (relating to definition of rents from real property in the case of real estate investment trusts);

(7) section 958 (b) (relating to constructive ownership rules with respect to controlled foreign corporations); and

(8) section 6038 (d) (1) (relating to information with respect to certain foreign corporations).

§ 331. *Gain or loss to shareholders in corporate liquidations.*

(a) General Rule.—

(1) *Complete liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock.

• • • • •

§ 337. *Gain or loss on sales or exchanges in connection with certain liquidations.*

(a) General Rule.—If—

(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and

(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims,

then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

• • • • •

§ 356. *Receipt of additional consideration.*

(a) Gain or Exchanges.—

(1) *Recognition of gain.*—if—

(A) section 354 or 355 would apply to an exchange but for the fact that

(B) the property received in the exchange consists not only of property permitted by section 354 or 355 to be received without the recognition of gain but also of other property or money,

then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) *Treatment as dividend.*—If an exchange is described in paragraph (1) but has the effect of the distribution of a dividend, then there shall be treated as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be treated as gain from the exchange of property.

• • • • •

§ 368. *Definitions relating to corporate reorganizations.*

(a) Reorganization.—

(1) *In general.*—For purposes of parts I and II and this part, the term "reorganization" means—

• • • • •

(D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, is in control of the corporation to which the assets are transferred; but only if, in pursuance of the plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under section 354, 355, or 356;

(c) *Control.*—For purposes of part I (other than section 304), part II, and this part, the term

"control" means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation.

[Trusts]

§ 643. *Definitions applicable to subparts A, B, C, and D*

(a) Distributable net income.—For purposes of this part, the term "distributable net income" means, with respect to any taxable year, the taxable income of the estate or trust computed with the following modifications—

• • • • •

(3) *Capital gains and losses.* — Gains from the sale or exchange of capital assets shall be excluded to the extent that such gains are allocated to corpus and are not (A) paid, credited, or required to be distributed to any beneficiary during the taxable year,

• • • • •

(b) Income.—For purposes of this subpart and subparts B, C, and D, the term "income", when not preceded by the words "taxable", "distributable net", "undistributed net", or "gross", means the amount of income of the estate or trust for the taxable year determined under the terms of the governing instrument and applicable local law. Items of gross income constituting extraordinary dividends or taxable stock dividends which the fiduciary, acting in good faith, determines to be allocable to corpus under the terms of the governing instrument and applicable local law shall not be considered income.

§ 661. *Deduction for estates and trusts accumulating income or distributing corpus*

(a) Deduction.—In any taxable year there shall be allowed as a deduction in computing the taxable income

of an estate or trust (other than a trust to which subpart B applies), the sum of—

(1) any amount of income for such taxable year required to be distributed currently (including any amount required to be distributed which may be paid out of income or corpus to the extent such amount is paid out of income for such taxable year); and

(2) any other amounts properly paid or credited or required to be distributed for such taxable year;

but such deduction shall not exceed the distributable net income of the estate or trust.

§ 662. *Inclusion of amounts in gross income of beneficiaries of estate and trusts accumulating income or distributing corpus*

(a) Inclusion.—Subject to subsection (b), there shall be included in the gross income of a beneficiary to whom an amount specified in section 661 (a) is paid, credited, or required to be distributed (by an estate or trust described in section 661), the sum of the following amounts:

(1) *Amounts required to be distributed currently.* —The amount of income for the taxable year required to be distributed currently to such beneficiary, whether distributed or not.

• • • • •

(2) *Other amounts distributed.* — All other amounts properly paid, credited, or required to be distributed to such beneficiary for the taxable year.

• • • • •

§ 671. *Trust income, deductions, and credits attributable to grantors and others as substantial owners*

Where it is specified in this subpart that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under this chapter in computing taxable income or credits against the tax of an individual. Any remaining portion of the trust shall be subject to subparts A through D. *No items of a trust shall be included in computing the taxable income and credits of the grantor or of any other person solely on the grounds of his dominion and control over the trust under section 61 (relating to definition of gross income) or any other provision of this title, except as specified in this subpart.* [Emphasis added.]

§ 673. *Reversionary interests*

(a) General rule.—The grantor shall be treated as the owner of any portion of a trust in which he has a reversionary interest in either the corpus or the income therefrom if, as of the inception of that portion of the trust, the interest will or may reasonably be expected to take effect in possession or enjoyment *within 10 years* commencing with the date of the transfer of that portion of the trust. [Emphasis added.]

• • • • •

§ 674. *Power to control beneficial enjoyment*

(a) General rule.—The grantor shall be treated as the owner of any portion of a trust in respect of which the

beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.

(b) Exceptions for certain powers.—Subsection (a) shall not apply to the following powers regardless of by whom held:

• • • • •

(2) Power affecting beneficial enjoyment only after expiration of 10-year period.—A power, the exercise of which can only affect the beneficial enjoyment of the income for a period commencing after the expiration of a period such that a grantor would not be treated as the owner under section 673 if the power were a reversionary interest; but the grantor may be treated as the owner after the expiration of the period unless the power is relinquished.

• • • • •

(8) Power to allocate between corpus and income.—A power to allocate receipts and disbursements as between corpus and income, even though expressed in broad language.

• • • • •

§ 676 *Power to revoke*

(a) General rule.—The grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under any other provision of this part, where at any time the power to revest in the grantor title to such portion is exercisable by the grantor or a nonadverse party, or both.

(b) Power affecting beneficial enjoyment only after expiration of 10-year period.—Subsection (a) shall not ap-

ply to a power the exercise of which can only affect the beneficial enjoyment of the income for a period commencing after the expiration of a period such that a grantor would not be treated as the owner under section 673 if the power were a reversionary interest. But the grantor may be treated as the owner after the expiration of such period unless the power is relinquished. [Emphasis added.]

§ 677. *Income for benefit of grantor*

(a) General rule.—The grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under section 674, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a non-adverse party, or both, may be—

* * * * *

(2) held or accumulated for future distribution to the grantor;

* * * * *

This subsection shall not apply to a power the exercise of which can only affect the beneficial enjoyment of the income for a period commencing after the expiration of a period such that the grantor would not be treated as the owner under section 673 if the power were a reversionary interest; but the grantor may be treated as the owner after the expiration of the period unless the power is relinquished. [Emphasis added.]

LEGISLATIVE HISTORY

The applicable provisions of the Internal Revenue Code of 1954 relating to trusts are analyzed in House Report No. 1337, Senate Report No. 1622, and Conference Report No. 2543 accompanying the 1954 Code. These reports indicate legislative intent in regard to a Clifford trust such as that involved herein. We quote some of the more pertinent comments found in the House Report.

26 U. S. C. § 671.

The above section was new in the 1954 Internal Revenue Code and no similar section was contained in the 1939 Code or those preceding it. The House Report includes these comments:

§ 671. *Trust income, deductions, and credits attributable to grantors and others as substantial owners.*

This section states the general rule that in cases where the grantor or another person is regarded as the owner of any portion of a trust, there shall be included in computing his taxable income and credits those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust (to the extent that such items would be taken into account in computing the taxable income and credits of an individual).

* * * * *

It is also provided in this section that no items of a trust shall be included in computing the income or credits of the grantor (or another person) solely on the grounds of his dominion and control over the trust under the provisions of section 61 (corresponding to sec. 22(a) of existing law). The effect of this provision is to insure that taxability of Clifford type trusts shall be governed solely by this subpart. * * * [Emphasis added.]

See 1954 U. S. Code Cong. and Adm. News pp. 4351, 4352. Similar language appears in the Senate Report found at pages 5005 and 5006.

26 U. S. Code § 673 (a).

Section 673 was also new in the 1954 Code. Included in the House report are these comments regarding section 673 (a):

§ 673. *Reversionary interests*

This section contains the rules applicable to the short-term trust containing the provision for a reversion to the grantor. The section enacts in statutory form provisions in lieu of those now contained in section 39.22(a)-21(c) of Regulations 118.

Subsection (a) of this section contains the general rule that a grantor shall be considered to be the owner of any portion of a trust (and taxable on the income therefrom) in which he has a reversionary interest in either the corpus or the income therefrom which will or may reasonably be expected to take effect in possession or enjoyment within a period of 10 years.

See 1954 U. S. Code Cong. and Adm. News, page 4353.

26 U. S. Code § 674

Section 674 likewise was first enacted in the 1954 Code.

The House Report includes these observations:

§ 674. *Power to control beneficial enjoyment*

This section contains provisions similar to those contained in subsection (d) of section 39.22(a)-21 of the regulations, providing for taxability to the grantor of income of a trust where the beneficial enjoyment of the corpus or income is subject to a power of disposition, exercisable by the grantor or by a nonadverse party or both. The general rule is contained in subsection (a) of this section while certain excepted powers are described in subsections (b) and (c).

Paragraph (1) of subsection (b) contains the exception, equivalent to that provided in section 167 (c) of the

1939 Code, under which a grantor is not taxable on income of a trust by reason of a power merely to apply income to the support or maintenance of his dependents. Inasmuch as such a power might subject the grantor to tax under the general rule of this section as well as under the general rule of section 677 (corresponding to sec. 167 of existing law) the exception is provided for in both sections.

Paragraph (2) contains an exception, also provided in the regulations, to the rules set forth in section 672 (d), under which powers exercisable only on giving of notice or at a future date are treated as present powers. Thus under the exception, a power which may only affect the income for a period commencing after 10 years will not subject the grantor to tax during the prior period. This exception correlates with the short-term trust rule in order that more severe tax consequences may not result from a power exercisable after a term of 10 years than from a reversionary interest to take effect after the same period. If the power is still in existence in the eleventh and succeeding years, however, the grantor will be taxable on the income of those years under the general rule since the power will be currently exercisable.

See 1954 U. S. Code Cong. and Adm. News, pp. 4353 and 4354.

26 U. S. Code § 676.

The House Report regarding this section indicates the legislative intent of subsection (b) thereof. It is stated therein:

§ 676. *Power to revoke*

Section 676 is the provision corresponding to section 166 of existing law providing that the grantor is taxable on the income of a trust where either he or any person without adverse interest has the power to revest title to the trust property in the grantor. *This provision is slight-*

ly modified so as to limit its application in the case of powers exercisable only after the expiration of a period of time. Under existing law the grantor is taxable if the power to revoke is exercisable "at any time". *As in the case of a power under section 674, it seems appropriate to correlate the section with the short-term trust provisions of section 673.* [Emphasis added.]

See 1954 U. S. Code Cong. and Adm. News, page 4356.

26 U. S. Code § 677.

The intent of Congress regarding the rule applicable to trusts extending for a ten-year period is again disclosed by the House Report regarding this section:

§ 677. *Income for benefit of grantor*

Section 677 corresponds to section 167 of existing law under which income is taxed to the grantor by reason of a power to vest the income in him or to apply it to his benefit. *A limitation with respect to powers affecting income arising only after the expiration of the period of time specified in section 673 is provided consistent with the treatment in sections 674 and 676.* [Emphasis added.]

See 1954 U. S. Code Cong. and Adm. News, pages 4356, 4357.

No. 76-1393

In the Supreme Court of the United States

OCTOBER TERM, 1976

JACK D. RINGWALT, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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OPINIONS BELOW

The memorandum opinion of the district court (Pet. App. 11-16) is not officially reported. The opinion of the court of appeals (Pet. App. 1-9) is reported at 549 F.2d 89.

JURISDICTION

The judgment of the court of appeals (Pet. App. 10-11) was entered on February 16, 1977. The petition for a writ of certiorari was filed on April 11, 1977. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether the transfer of all of the operating assets from one corporation to another identically-constituted corporation with the same shareholders, which thereupon carried on the business of the transferor, was a reorganization within the meaning of Section 368(a)(1)(D) of the Internal Revenue Code of 1954, so that the transferor's distribution of its retained cash to its shareholders was taxable as a dividend under Section 356 of the Code.

2. Whether petitioner Ringwalt, who received the corporate distribution in his capacity of trustee of a short-term trust in 1967, was individually taxable on the distribution in that year under Sections 671 and 677(a)(2) of the Code.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of Sections 368, 671, and 677 of the Internal Revenue Code of 1954 (26 U.S.C.) and of Sections 1.671-2 and 1.677(a)-1 of the Treasury Regulations on Income Tax (26 C.F.R.) are set forth in the Appendix, *infra*, pp. 1a-5a.

STATEMENT

Ringwalt & Liesche, Inc. (R & L, Inc.) was incorporated in Nebraska on July 1, 1949, and operated a general insurance agency. Petitioner Jack D. Ringwalt [1] owned 84 percent of the stock of R & L, Inc.

[1] References to Ringwalt are to petitioner Jack D. Ringwalt. Jean W. Ringwalt is a party solely because she filed a joint return with her husband for the year in issue.

Ringwalt originally owned this stock outright. After April 30, 1959, however, he held his interest in R & L, Inc. as a self-declared trustee under a short-term trust. The balance of the R & L, Inc. stock was owned as follows: petitioner Philip L. Liesche—eight percent, Charles B. Wortz—six percent, and Daniel J. Gross—two percent (Pet. App. 2; R. 24).[2]

From its organization until its liquidation in 1967, R & L, Inc.'s board of directors consisted of Ringwalt, Liesche, and Wortz. Throughout this period, Ringwalt served as president, Liesche as vice-president, and since 1952, Wortz served as treasurer. By March 31, 1967, R & L, Inc. had accumulated earnings and profits of $810,421.50 (Pet. App. 2; R. 23-25).

At the beginning of January, 1967, R & L, Inc. owned 2,582 shares (51 percent) of National Fire and Marine Insurance Company, a Nebraska casualty insurance company formed by Ringwalt. By a tender offer dated February 23, 1967, Berkshire-Hathaway, Inc. offered to purchase all of the outstanding shares of National Fire and Marine. Ringwalt had previously committed himself in writing to accept this offer with respect to all National Fire and Marine stock that he owned or controlled. Accordingly, on or about March 16, 1967, R & L, Inc. sold its National Fire and Marine stock to Berkshire-Hathaway, Inc. for $839,100, and realized a gain of $706,301.87 (Pet. App. 3, 12; R. 26-27).

[2] "R." refers to the record appendix filed in the court of appeals.

In anticipation of this sale, the shareholders of R & L, Inc., on February 22, 1967, adopted a resolution authorizing and directing the dissolution of the corporation as of March 31, 1967. At that time, the shareholders contemplated that the operating assets of R & L, Inc. (consisting of insurance renewals and associated assets) would be sold to a new company to be formed by Ringwalt and which was to commence business on April 1, 1967. R & L, Inc. had its operating assets valued by an outside appraiser, who concluded that the new company could use a value of $165,000 as a basis for amortization for federal tax purposes (R. 27, 28, 50).

On April 1, 1967, the new company was organized as a Nebraska corporation under the name Ringwalt & Liesche Co. (R & L Co.). The shares of the new corporation were held in the same proportions as in the old corporation: Ringwalt—84 percent, Liesche—eight percent, Wortz—six percent, and Gross—two percent. Ringwalt, Liesche, and Wortz likewise comprised the board of directors of R & L Co., and respectively served as president, vice president, and treasurer. On April 1, 1967, R & L Co. paid or credited to R & L, Inc. $165,000 for its operating assets plus $5,000 for the use of a similar corporate name. R & L Co. continued to conduct the business formerly conducted by R & L, Inc. in substantially the same manner and at the same location (Pet. App. 3; R. 27-30).

On or about April 1, 1967, R & L, Inc. was dissolved, and distributed to its shareholders its remaining nonoperating assets, totalling $1,110,421.50. Of

this amount, $932,754.06 was distributed to petitioner Ringwalt in his capacity as trustee under a short-term trust, $88,833.72 to petitioner Liesche, and the balance to the remaining two shareholders, including pro rata amounts derived from R & L, Inc.'s sale of the National Fire and Marine stock and the transfer of its operating assets to R & L Co. (Pet. App. 3; R. 27, 30).

The principal purpose for the dissolution of R & L, Inc. and the formation of R & L Co. was to avoid federal income taxes (Pet. App. 15) by means of (1) the non-recognition by R & L, Inc. of its gain on the National Fire and Marine stock, pursuant to the special liquidation provisions of Section 337 of the Code, (2) the withdrawal by its shareholders of the earnings and profits of R & L, Inc. at capital gain rates, and (3) the establishment of a stepped-up basis in the operating assets with respect to which R & L Co. might claim deductions for amortization or depreciation (R. 29).

Prior to the liquidation of R & L, Inc., petitioner Ringwalt had established on April 30, 1959, a trust known as the Ringwalt Short Term Trust (trust). This trust was to continue for ten years and one day, and terminated on May 1, 1969. Ringwalt was the sole trustee, and his children were the income beneficiaries. Ringwalt retained a reversionary interest in the corpus. Ringwalt transferred to himself, as trustee, the shares of R & L, Inc. stock which he owned. The trust held this stock until R & L, Inc. was dissolved on April 1, 1967. At that time, Ringwalt

received the $932,754.06 liquidating distribution from R & L, Inc., in his capacity as trustee, although he reported the gain from this distribution on his 1967 individual income tax return. Thereafter, the trust invested this money in securities of publicly held companies, and, when the trust terminated on May 1, 1969, the funds were paid over to Ringwalt (Pet. App. 2-3, 11-13, 15).

Under the trust, Ringwalt had sole discretion to allocate trust receipts between principal (*i.e.*, to himself as holder of the reversionary interest) and income. Although Ringwalt's power of allocation had to be exercised in a fiduciary capacity, any such decision made in good faith was conclusive on all beneficiaries or any other interested persons. Ringwalt allocated the liquidating distribution from R & L, Inc. to principal, and the resulting accumulation was eventually distributed to him individually upon termination of the trust (Pet. App. 3, 15; R. 30, 40-42).

On its federal income tax return for its taxable year ended March 31, 1967, R & L, Inc. reported no gain with respect to its sale of the National Fire and Marine stock, or with respect to the transfer of its operating assets to R & L Co. On their individual returns for 1967, petitioners Ringwalt and Liesche each reported the liquidating distribution received from R & L Inc. as long-term capital gain, in exchange for his stock in the corporation. On audit, the Commissioner of Internal Revenue determined that the series of steps whereby R & L Inc. transferred its assets to R & L Co. and then dissolved was

a "reorganization" within the meaning of Section 368(a)(1)(D) of the Internal Revenue Code of 1954. Thus, R & L, Inc. was not entitled to the nonrecognition of income benefits of Section 337, and its shareholders were required to treat the liquidating distribution, to the extent of their respective gain, as having the effect of the distribution of a dividend under Section 356, rather than as capital gain (Pet. App. 4, 13; R. 32).

Accordingly, the Commissioner determined a deficiency of $176,575.76 against R & L, Inc., which was assessed against Ringwalt as the transferee of corporate assets under Section 6901. The Commissioner also determined deficiencies against Ringwalt and Liesche individually of $150,347.97 and $11,401.18, respectively, treating the R & L, Inc. liquidating distributions as dividends, with appropriate adjustments made for (i) their capital contributions to R & L Co., as well as (ii) their pro rata shares of the deficiencies determined against R & L, Inc., which had reduced R & L Inc.'s earnings and profits (Pet. App. 4, 13; R. 32-33).

In this refund suit brought by petitioners in the United States District Court for the District of Nebraska, the district court held that the transaction between R & L, Inc. and R & L Co. was a reorganization under Section 368(a)(1)(D), so that the resulting distributions were taxable to petitioners as dividends (Pet. App. 10-15). The court of appeals affirmed (Pet. App. 1-11).

As the court of appeals observed, the continuity of proprietary interest required for a reorganization

was satisfied because Ringwalt retained a substantial beneficial interest in the R & L, Inc. stock held in trust. Moreover, under Section 677(a)(2), as a grantor-owner of the trust, Ringwalt was the owner of the R & L, Inc. stock held in trust because the 1967 R & L, Inc. liquidating distribution was allocated by Ringwalt to trust corpus, held for future distribution to himself, and was in fact distributed to himself outright when the trust terminated in 1969. As a result, the court of appeals held that Ringwalt was properly taxable on the R & L, Inc. distribution in 1967, when it was received by the trust, and not in 1969, upon the termination of the trust (Pet. App. 9, n. 11).

ARGUMENT

1. The court of appeals correctly held that the transaction between R & L, Inc. and R & L Co. was a reorganization within the meaning of Section 368(a)(1)(D) of the Code. As the court of appeals pointed out (Pet. App. 5-6), the transaction in this case is a classic "liquidation-reincorporation," which has been uniformly held to be a Section 368(a)(1)(D) reorganization. See, *e.g.*, *Babcock* v. *Phillips*, 372 F. 2d 240 (C.A. 10), certiorari denied, 387 U.S. 918; *Davant* v. *Commissioner*, 366 F. 2d 874 (C.A. 5), certiorari denied, 386 U.S. 1022; *Moffatt* v. *Commissioner*, 363 F. 2d 262 (C.A. 9), certiorari denied, 386 U.S. 1016; *Commissioner* v. *Morgan*, 288 F. 2d 676 (C.A. 3), certiorari denied, 368 U.S. 836; *Liddon* v. *Commissioner*, 230 F. 2d 304 (C.A. 6), certiorari denied, 352 U.S. 824; *Bard-Parker Co.* v. *Commissioner*, 218 F. 2d 52 (C.A. 2), certiorari denied, 349 U.S. 906; *Lewis* v. *Commissioner*, 176 F. 2d 646 (C.A. 1); *Survaunt* v. *Commissioner*, 162 F. 2d 753 (C.A. 8).

However, petitioners argue that the transaction was not a reorganization because Ringwalt, while holding his stock in R & L, Inc. as a self-declared trustee under a short-term trust, was not a "shareholder" of that corporation within the meaning of Section 368(a)(1)(D). Pursuant to that provision, a "reorganization" includes a transaction in which the assets of one corporation are transferred to another corporation, and either the transferor corporation or one or more of its "shareholders," or both, are in control of the transferee corporation immediately after the transfer.

But the court of appeals correctly applied the settled principle that beneficial enjoyment, as opposed to bare legal title, is the determining factor in assessing the continuity of proprietary interest necessary for a reorganization (see Pet. App. 7-8). See, *e.g.*, *Commissioner* v. *National Bellas Hess, Inc.*, 220 F. 2d 415 (C.A. 8), rehearing denied, 225 F. 2d 340; *Bondy* v. *Commissioner*, 269 F. 2d 463 (C.A. 4); *Ridgewood Cemetery Co.* v. *Commissioner*, 26 B.T.A. 626; *Federal Grain Corp.* v. *Commissioner*, 18 B.T.A. 242. Moreover, as the court of appeals correctly pointed out (Pet. App. 8-9), a grantor, such as Ring-

walt, who is a substantial owner of a trust under the grantor trust provisions (Sec. 671, *et seq.*, Internal Revenue Code of 1954 (26 U.S.C.)) should, in appropriate circumstances, be treated as actually owning the trust assets. See *Swanson* v. *Commissioner*, 518 F. 2d 59 (C.A. 8); cf. *Helvering* v. *Clifford*, 309 U.S. 331.

The record amply supports the application of these principles by both courts below. Thus, the court of appeals found "that Ringwalt was treated appropriately as the owner of 84% of the R & L, Inc. stock because of the significant incidence of his ownership over the trust property," and that "The only beneficial right that Ringwalt relinquished under the trust agreement was the right to receive trust receipts allocable to income" for the ten year duration of the trust (Pet. App. 7-8). On these facts, the court properly held (Pet. App. 8-9) that Ringwalt was a grantor-owner of the trust under Section 677(a)(2), Appendix, *infra*, pp. 2a-3a, because "In accordance with Ringwalt's powers as trustee, the 1967 liquidating distribution received from dissolution of R & L, Inc. was allocated to principal, held by the trust for future distribution and actually distributed to Ringwalt upon termination of the trust in 1969" (Pet. App. 8). These facts exactly fit the operative words of Section 677(a), which provides that "The grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under section 674, whose income without the approval or consent of any adverse party is * * * (2) held or

accumulated for future distribution to the grantor * * *."[3]

2. Finally, petitioners contend (Pet. 20-21) that Ringwalt should be taxable upon the R & L, Inc. distribution upon the termination of the trust in 1969, and not in 1967, when the trust received the distribution. But under Section 677(a)(2), Ringwalt was the owner of the trust in 1967 because the R & L, Inc. distribution was allocated to principal, held for future distribution to Ringwalt, and was in fact distributed to him free of the trust in 1969. Thus, under Section 671, Ringwalt was required to and did report that income on his individual return for 1967 as if he had personally received it in that year. Treasury Regulations, Section 1.671-2(c), Appendix, *infra*, p. 4a. See *Graff* v. *Commissioner*, 117 F.2d

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[3] Contrary to petitioners' argument (Pet. 12, 19), the decision below does not conflict with *Commissioner* v. *Berghash*, 361 F.2d 257 (C.A. 2), affirming *per curiam*, 43 T.C. 743. There, the court held that the liquidation-reincorporation of a corporation was not a (D) reorganization because the former 10 percent shareholder of the "old" corporation owned only 50 percent of the stock of the "new" corporation. Thus, the 80 percent control requirement (see Section 368(c), Appendix, *infra*, p. 1a) for a (D) reorganization was not met. Here, however, petitioner Ringwalt owned 84 percent of the stock of the newly-formed R & L Co. and was therefore in "control" of that corporation.

Nor does the decision in this case conflict with *Commissioner* v. *Gordon*, 382 F.2d 499 (C.A. 2) (Pet. 19). Apart from the fact that the court of appeals' decision in *Gordon* was reversed by this Court in *Commissioner* v. *Gordon*, 391 U.S. 83, that case involved the spin-off provisions of Section 355 and not Section 368(a)(1)(D).

247 (C.A. 7); Rev. Rul. 58-242, 1958-1 Cum. Bull. 251.

Petitioners argue (Pet. 21) that these rules are applicable only if the R & L, Inc. liquidating distribution is determined to be capital gain. But Section 677(a) is not so limited, and refers to all items of trust "income" that are, or may be, held for future distribution to the grantor. Trust "income" for this purpose is determined without regard to characterization of the item as "income" or "principal" for purposes of trust accounting under state law. Treasury Regulations, Section 1.671-2(b), Appendix, *infra*, pp. 3a-4a. Indeed, petitioners concede (Pet. 21) that Ringwalt properly reported the liquidating distribution as his own income in 1967, because he did in fact accumulate it for future distribution to himself. That is all that Section 677(a)(2) requires.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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JUNE 1976.

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 368. DEFINITIONS RELATING TO CORPORATE REORGANIZATIONS.

(a) *Reorganization.*—

(1) *In general.*—For purposes of parts I and II and this part, the term "reorganization" means—

* * * * *

(D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, is in control of the corporation to which the assets are transferred; but only if, in pursuance of the plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under section 354, 355, or 356;

* * * * *

(c) *Control.*—For purposes of part I (other than section 304), part II, and this part, the term "control" means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation.

SEC. 671. TRUST INCOME, DEDUCTIONS, AND CREDITS ATTRIBUTABLE TO GRANTORS AND OTHERS AS SUBSTANTIAL OWNERS.

Where it is specified in this subpart that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under this chapter in computing taxable income or credits against the tax of an individual. Any remaining portion of the trust shall be subject to subparts A through D. No items of a trust shall be included in computing the taxable income and credits of the grantor or of any other person solely on the grounds of his dominion and control over the trust under section 61 (relating to definition of gross income) or any other provision of this title, except as specified in this subpart.

SEC. 677. INCOME FOR BENEFIT OF GRANTOR.

(a) *General Rule.*—The grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under section 674, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be—

(1) distributed to the grantor * * *;

(2) held or accumulated for future distribution to the grantor * * *; or

(3) applied to the payment of premiums on policies of insurance on the life of the grantor * * * (except policies of insurance irrevocably payable for a purpose specified in section 170(c) (relating to definition of charitable contributions)).

This subsection shall not apply to a power the exercise of which can only affect the beneficial enjoyment of the income for a period commencing after the expiration of a period such that the grantor would not be treated as the owner under section 673 if the power were a reversionary interest; but the grantor may be treated as the owner after the expiration of the period unless the power is relinquished.

* * * * *

Treasury Regulations on Income Tax, 1954 Code (26 C.F.R.):

§ 1.671-2 *Applicable principles.*

* * * * *

(b) Since the principle underlying subpart E (section 671 and following), part I, subchapter J, chapter 1 of the Code, is in general that income of a trust over which the grantor or another person has retained substantial dominion or control should be taxed to the grantor or other person rather than to the trust which receives the income or to the beneficiary to whom the income may be distributed, it is ordinarily immaterial whether the income involved constitutes income or corpus for trust accounting purposes.

Accordingly, when it is stated in the regulations under subpart E that "income" is attributed to the grantor or another person, the reference, unless specifically limited, is to income determined for tax purposes and not to income for trust accounting purposes. When it is intended to emphasize that income for trust accounting purposes (determined in accordance with the provisions set forth in § 1.643(b)-1) is meant, the phrase "ordinary income" is used.

(c) An item of income, deduction, or credit included in computing the taxable income and credits of a grantor or another person under section 671 is treated as if it had been received or paid directly by the grantor or other person (whether or not an individual). * * *

(d) Items of income, deduction, and credit not attributed to or included in any portion of a trust of which the grantor or another person is treated as the owner under subpart E are subject to the provisions of subparts A through D (section 641 and following), of such part I.

* * * * *

§ 1.677(a)-1 *Income for benefit of grantor, general rule.*

(f) *Accumulation of income.* If income is accumulated in any taxable year for future distribution to the grantor (or his spouse in the case of property transferred in trust by the grantor after Oct. 9, 1969), section 677(a)(2) treats the grantor as an owner for that taxable year. The exception set forth in the last sentence of section 677(a) does not apply merely because the grantor (or his spouse in the case of prop-

erty transferred in trust by the grantor after Oct. 9, 1969) must await the expiration of a period of time before he or she can receive or exercise discretion over previously accumulated income of the trust, even though the period is such that the grantor would not be treated as an owner under section 673 if a reversionary interest were involved. Thus, if income (including capital gains) of a trust is to be accumulated for 10 years and then will be, or at the discretion of the grantor, or his spouse in the case of property transferred in trust after October 9, 1969, or a nonadverse party, may be, distributed to the grantor (or his spouse in the case of property transferred in trust after Oct. 9, 1969), the grantor is treated as the owner of the trust from its inception. If income attributable to transfers after October 9, 1969 is accumulated in any taxable year during the grantor's lifetime for future distribution to his spouse, section 677(a)(2) treats the grantor as an owner for that taxable year even though his spouse may not receive or exercise discretion over such income prior to the grantor's death.

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